Yum China Holdings, Inc. (YUMC)

Updated February 28th, 2024, by Yiannis Zourmpanos

Key Metrics

Current Price:	$43	**5 Year CAGR Estimate:**	26.7%	**Market Cap:**	$18.12 B
Fair Value Price:	$68	**5 Year Growth Estimate:**	15.0%	**Ex-Dividend Date:**	03/04/2024
% Fair Value:	63%	**5 Year Valuation Multiple Estimate:**	9.6%	**Dividend Payment Date:**	03/26/2024
Dividend Yield:	1.5%	**5 Year Price Target**	$137	**Years Of Dividend Growth:**	2
Dividend Risk Score:	C	**Retirement Suitability Score:**	F	**Rating:**	Buy

Overview & Current Events

Yum China Holdings, Inc. (YUMC) is China's largest restaurant company, with over 14,644 restaurants in over 2,000 cities. Yum China separated from Yum! Brands in October 2016.

On February 6th, 2024, Yum China announced Q4 2023 results reporting non-GAAP diluted EPS of $0.25, beating market estimates by $0.09. The revenue for the quarter was reported at $2.49 billion, up 19.1% year-over-year.

On an annual basis, total system sales grew 21% year-over-year, excluding the impact of foreign currency translation. This was driven primarily by a net new unit contribution of 12%, same-store sales growth of 4%, and recovery from pandemic-related temporary closures last year. That included opening 542 net new stores, taking Yum China to 14,644 across the country, including 10,296 for KFC and 3,312 for Pizza Hut. Revenue for the quarter rose 19% to $2.49 billion but increased 21% when adjusted for the changes in foreign currencies. The company witnessed a massive jump in operating profit, swelling by 170% to $110 million, while the core operating profit increased by 324%.

Additionally, the margin from restaurants also improved to 10.7% with an eye-catching expansion of 170 basis points after making adjustments for the same in comparability items. On the front of full-year results, Yum China continued the same strong growth trajectory, with total system sales growing 21% on an local currency basis. This was driven by a 9% increase in net new unit contributions and 7% from same-store sales growth versus the previous year's temporary closures because of the pandemic. The company achieved its full-year target, adding 1,697 net new stores, an increase of 13%, and the total revenues rose 15% to $10.98 billion, 21% in constant currency. Operating profit rose by 76% to $1.1 billion, with core operating profit increasing by 79%. Finally, restaurant margins expanded meaningfully to 16.3% when excluding some comparability items.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	-	-	$1.36	$1.01	$1.24	$1.84	$1.51	$1.22	$1.20	$1.97	***$2.27***	***$4.56***
DPS	-	-	-	$0.10	$0.42	$0.48	$0.24	$0.48	$0.48	$0.52	***$0.64***	***$0.77***
Shares	-	-	383.3	384.7	379.0	376.0	420.0	428.0	423.0	420.0	***421.4***	***449.9***

Yum China has grappled with COVID-19-related challenges with intermittent lockdowns from 2020 to the current year, which has affected its earnings in recent years. However, we believe the company is well-positioned for growth in the coming years with a favorable industry outlook. The fast-food restaurant industry still has a lot of room for growth, constituting only about 17% of restaurant spending compared with 61% in the US. We believe the trend will change in the coming years, driven by secular trends and Yum China.

Yum China intends to open 1,500 to 1,700 net new stores in 2024 and allocate $700 million to $850 million for capital expenditures. The company has some very aggressive goals set from 2024 to 2026, increasing its store count to 20,000 by 2026, achieving a high-single to double-digit system sales and operating profit CAGR, as well as for EPS, based on 2023, excluding F/X. Beyond this, Yum China has a goal that at least $3 billion of capital will be returned to shareholders through dividends and share repurchases. Therefore, we maintain our EPS growth rate at 15.0%, which reflects the company's growth prospects as China's economy is recovering. The company continues to expand its store count, which will catalyze EPS growth in the next five years. In addition, the company will be able to grow its dividends at a healthy pace in the future and has assumed a dividend growth rate of 20.0% for the next five years.

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Avg. P/E	-	-	20.0	35.1	31.4	23.9	33.2	48.6	39.8	28.3	***19.0***	***30.0***
Avg. Yld.	-	-	-	0.3%	1.1%	1.1%	0.5%	0.8%	1.0%	0.9%	***1.5%***	***0.6%***

Yum China is trading at a forward P/E of 19.0, significantly lower than the five-year average of 34.7. The stock is trading at a discount due to the uncertain economic outlook of the Chinese economy. We expect the P/E to normalize as earnings grow and have assumed a conservative P/E of 30.0 by 2029, leading to our 5-year price target of $137.

Safety, Quality, Competitive Advantage, & Recession Resiliency

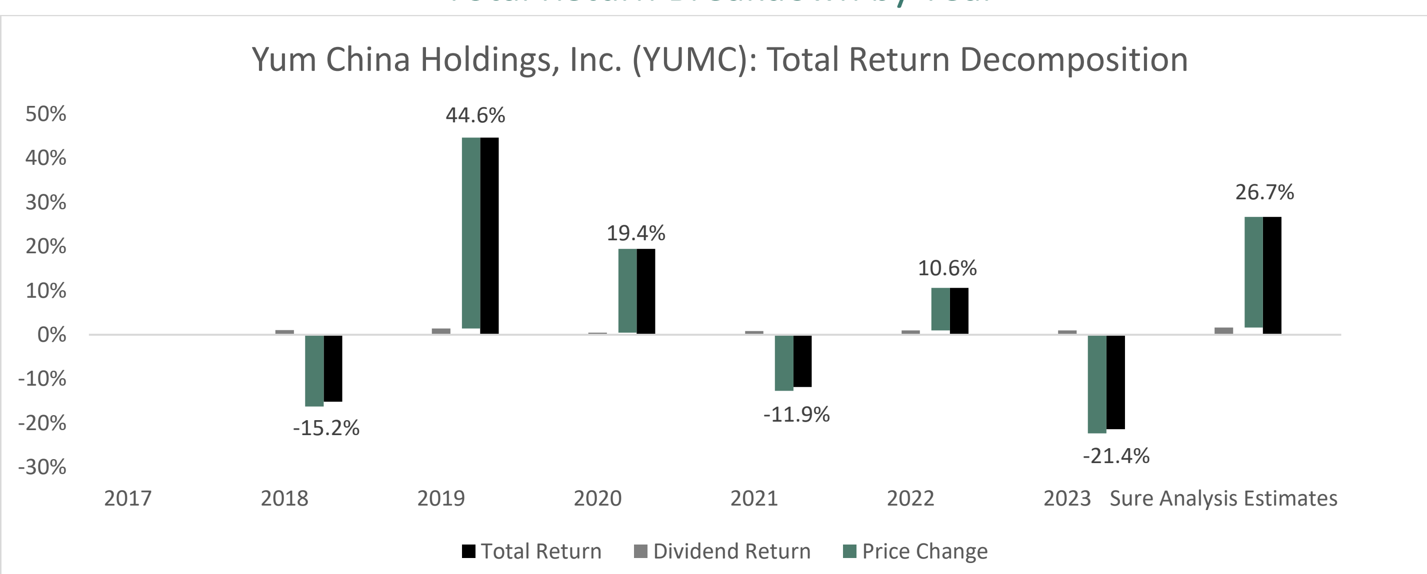
Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	-	-	0%	10%	34%	26%	16%	39%	40%	26%	***28%***	***17%***

Yum China's most important competitive advantage is its high brand value. Moreover, focusing on menu innovations and efficient supply chain infrastructure, which results in cost advantages compared to smaller brands, gives Yum China an edge over other fast-food restaurant businesses. In addition, Yum China, as the largest restaurant chain, benefits from economies of scale, which allows it to exert significant influence over suppliers and guarantee access to food and other raw materials at stable, reasonable pricing. The business also operates in a recession-proof industry since everyone still requires food and drink to survive, no matter the macroeconomic situation. Yum China has $1.5 billion available for future share repurchases, highlighting its commitment to shareholder value. In the fourth quarter, the company returned $390 million to shareholders, culminating in a record annual return of $833 million through share repurchases and dividends. This financial strategy underscores Yum China's robust performance and dedication to enhancing investor returns.

Final Thoughts & Recommendation

The company's fundamental business model is solid and will continue to thrive. The company has a solid balance sheet with $2.6 billion available in cash and short-term investments as of the last quarter, which it can utilize to continue to expand and pay dividends to shareholders. We maintain our buy rating premised upon the 26.7% annualized total returns for the medium-term, driven by forecasted earnings-per-share growth of 15.0%, a starting yield of 1.5%, and a valuation tailwind.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	6,905	6,934	6,909	7,075	7,769	8,415	8,776	8,263	9,853	9,569
Gross Profit	880	841	908	1,096	1,284	1,315	1,401	1,267	1,406	1,427
Gross Margin	12.7%	12.1%	13.1%	15.5%	16.5%	15.6%	16.0%	15.3%	14.3%	14.9%
SG&A Exp.	356	389	395	429	495	456	487	479	564	594
D&A Exp.	394	411	425	402	409	445	428	450	516	602
Operating Profit	529	469	511	652	761	830	863	709	734	658
Op. Margin	7.7%	6.8%	7.4%	9.2%	9.8%	9.9%	9.8%	8.6%	7.4%	6.9%
Net Profit	126	(7)	323	498	398	708	713	784	990	442
Net Margin	1.8%	-0.1%	4.7%	7.0%	5.1%	8.4%	8.1%	9.5%	10.0%	4.6%
Free Cash Flow	782	775	913	866	884	1,333	1,185	1,114	1,131	734
Income Tax	135	54	168	156	379	214	260	295	369	207

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets		3,257	3,201	3,727	4,287	4,610	6,950	10,875	13,223	11,830
Cash & Equivalents		238	425	885	1,059	1,266	1,046	1,158	1,136	1,130
Acc. Receivable		60	33	74	79	80	88	99	67	64
Inventories		260	189	268	297	307	380	398	432	417
Goodwill & Int.		216	192	167	340	520	481	1,218	2,552	2,270
Total Liabilities		1,303	1,216	1,284	1,440	1,633	3,775	4,404	5,301	4,666
Accounts Payable		501	438	480	420	619	623	708	830	727
Long-Term Debt		-	-	-	-	-	-	-	-	-
Total Equity		1,888	1,921	2,377	2,765	2,873	3,077	6,206	7,056	6,482
LTD/E Ratio		-	-	-	-	-	-	-	-	-

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets			10.0%	14.4%	9.9%	15.9%	12.3%	8.8%	8.2%	3.5%
Return on Equity			17.0%	23.2%	15.5%	25.1%	24.0%	16.9%	14.9%	6.5%
ROIC			16.4%	22.5%	15.0%	24.3%	23.2%	16.3%	13.8%	5.9%
Shares Out.	-	-	-	383.3	384.7	379.0	376.0	420.0	428.0	425.0
Revenue/Share	17.71	17.78	17.72	19.17	19.52	21.30	22.62	20.55	22.70	22.52
FCF/Share	2.01	1.99	2.34	2.35	2.22	3.37	3.05	2.77	2.61	1.73

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.